

Message Text

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ACTION EA-10

INFO OCT-01 ISO-00 IO-04 AID-05 CIAE-00 COME-00 EB-04

FRB-01 INR-05 NSAE-00 RSC-01 TRSE-00 XMB-02 OPIC-03

SP-02 CIEP-01 LAB-01 SIL-01 OMB-01 DODE-00 PM-03 H-01

L-01 NSC-05 PA-01 PRS-01 SS-15 USIA-06 AGR-05 STR-01

ACDA-05 FEA-01 INT-05 OES-02 /094 W

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R 040902Z NOV 74

FM AMEMBASSY SEOUL

TO SECSTATE WASHDC 6759

INFO AMEMBASSY TOKYO

AMCONSUL HONG KONG

CINCPAC

C O N F I D E N T I A L SECTION 1 OF 2 SEOUL 7321

HONG KONG FOR REGFINATT

E.O. 11652: GDS

TAGS: ECON KS PINT

SUBJECT: ECONOMIC RECESSION WILL BRING FOREIGN FINANCING AND
UNEMPLOYMENT PROBLEMS

REFS: A. SEOUL A-257

B. SEOUL A-256

C. SEOUL 6654

SECTION I OF III SECTIONS (BOP SITUATION)

SUMMARY: RECENT INDICATIONS ARE THAT AS RESULT INTERNATIONAL
RECESSION KOREA HAS BEGUN ITS SHARPEST AND MOST PROLONGED
DECLINE IN EXPORTS AND INDUSTRIAL PRODUCTION SINCE RAPID
GROWTH BEGAN IN 1963. CHIEF PROBLEMS WILL BE TO FIND LARGE
VOLUME FOREIGN FINANCING AND AVOID SERIOUS UNEMPLOYMENT.

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URGENT NEED FOR FOREIGN FINANCING IS DRAMATIZED BY FIFTY-ONE

PERCENT FALL IN NET FOREIGN ASSETS SINCE BEGINNING YEAR, TO DOLS 464 MILLION AT END SEPTEMBER, WHICH IS LESS THAN ONE MONTHS IMPORTS. EXTRAORDINARY FINANCING MAY BE REQUIRED IN 1975. DEPRESSING EFFECTS OF SUSTAINED DOWNTURN IN KOREA'S EXPORTS AS WELL AS INCREASED COST OF IMPORTS HAVE INEVITABLY BEGUN TO SPREAD TO DOMESTIC ECONOMY. INDUSTRIAL PRODUCTION IS DOWN. BUSINESS PROFITS NOT ONLY OF MAJOR EXPORT-ORIENTED FIRMS BUT OF MANY SMALLER BUSINESSES HAVE BEEN SQUEEZED, BANKRUPTCIES MAY BE RISING SUBSTANTIALLY, UNEMPLOYMENT HAS RISEN AND WAGE INCREASES HAVE NOT KEPT PACE WITH COST OF LIVING INCREASES. INEVITABLY THESE DEVELOPMENTS HAVE HAD POLITICAL EFFECTS AND THE EMBASSY IS BEGINNING TO HEAR INCREASINGLY WIDESPREAD TALK ABOUT POSSIBLE DETRIMENTAL EFFECTS OF ECONOMIC STRAINS ON POLITICAL SCENE, AMONG POLITICAL AS WELL AS ECONOMIC FIGURES. AS FOR THE DEGREE AND TIMING OF POLITICAL CONSEQUENCES OUR CRYSTAL BALL REMAINS OPAQUE. HOWEVER, ROKG ITSELF SEEMS MOST ANXIOUS TO PREVENT SPREAD TO LABOR SECTOR OF CURRENT ANTI-REGIME PROTEST MOVEMENT AND IS BEGINNING TO DEVOTE MAJOR, PREEMPTIVE AND REMEDIAL EFFORTS TO KEEP LABOR QUIET. END SUMMARY.

1. DECLINE SINCE MAY IN EXPORT ORDERS FORECASTS FAIRLY SHARP DECLINE IN KOREAN INDUSTRIAL PRODUCTION AND CONTINUED NEED FOR VERY LARGE VOLUME BOP FINANCING. SINCE RECOVERY IN EXPORTS WILL LARGELY DEPEND ON UPTURNS IN US AND JAPANESE ECONOMIES, A RECESSION LASTING UNTIL AT LEAST MID-1975 APPEARS PROBABLE. THIS WOULD BE FIRST SIGNIFICANT DOWNTURN IN PRODUCTION AND EXPORTS SINCE KOREA BEGAN RAPID GROWTH AND INDUSTRIALIZATION IN 1963. WITH BOP DEFICIT ALREADY GREATLY ENLARGED BY HIGHER OIL AND OTHER PRICES, CAUSING FIFTY-ONE PERCENT LOSS OF NET FOREIGN ASSETS IN FIRST NINE MONTHS, DECLINING EXPORTS WILL ADD TO ALREADY LARGE FOREIGN FINANCING NEEDS. KOREAN OFFICIALS STILL HOPE TO BORROW THEIR WAY THROUGH THE RECESSION, RELYING ON IMF AND NORMAL BANK CREDITS, BUT EXTRAORDINARY FINANCING MAY BE REQUIRED.

2. 1974 BOP OUTLOOK: EXPORT SHIPMENTS HAVE BEEN ALMOST CONSTANT IN VALUE TERMS SINCE MAY, MEANING SOME DECLINE IN REAL TERMS. EXPORT ORDERS IN VALUE TERMS HAVE BEEN IN DOWNTREND
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SINCE MAY. SEPTEMBER ORDER FIGURE PARTICULARLY LOW AT 33 PERCENT BELOW MAY PEAK AND 9 PERCENT BELOW YEAR-EARLIER VALUE, DESPITE INCFEASE IN EEXPORT PRICE INDEX OF OVER 30 PERCENT SINCE LAST SEPTEMBER. WHILE OCTOBER ORDER FIGURE MAY BE SOMEWHAT HIGHER, OUTLOOK IS FOUR CONTINUED DOWNTREND IN EXPORT ORDERS FOR NEXT SEVERAL MONTHS BEFORE HOPED-FOR LEVELING OFF, WHICH SHOULD RESULT IN EXPORT SHIPMENT DOWNTREND THIS QUARTER AND NEXT QUARTER. TEXTILES AND PLYWOOD HAVE BEEN

PARTICULARLY HARD HIT BUT ELECTRONICS HAVE ALSO SUFFERED RECENTLY.

3. IMPORTS HAVE ALSO LEVELED OFF SINCE MAY AND SHOULD ALSO DECLINE BUT TO LESSER EXTENT, SINCE DIRECT IMPORT COMPONENT OF EXPORTS ONLY ABOUT 40 PERCENT. BUT WHILE IMPORTS HAVE LEVELED THEIR COSTS HAVE RISEN SHARPLY. THE COST OF GRAIN IMPORTS ROSE FROM 283 MILLION DOLLARS IN 1972 TO AN ESTIMATED 707 MILLION FOR 1974. CRUDE COSTS ROSE FROM 206 MILLION DOLLARS TO 1.1 BILLION DOLLARS DURING SAME PERIOD, REPRESENTING AN INCREASE OF 274 PERCENT FOR THE COMBINED COST OF FOOD AND CRUDE. IN 1972 THESE ESSENTIAL COMMODITIES REPRESENTED 19 PERCENT OF THE IMPORT BILL, IN 1974 THE PERCENTAGE ROSE TO 28 PERCENT.

4. AS EXPLAINED IN REF A, 1974 BOP CURRENT ACCOUNT DEFICIT WILL BE ABOUT DOLS 1.4 - 1.5 BILLION, COMPARED TO ORIGINAL ESTIMATE OF DOLS 1.0 BILLION AND 1973 DEFICIT OF DOLS 309 MILLION. DEFICIT IS EXPECTED TO BE FINANCED BY ROUGHLY DOLS 600 MILLION NET IN REGULAR LONG-TERM CAPITAL, DOLS 250 MILLION NET IN LONG - TERM BANK LOANS, UP TO DOLS 100 MILLION IN IMF CREDITS AND AT LEAST DOLS 450 MILLION IN NET SHORT-TERM CREDITS AND OTHER CAPITAL. IF ACHIEVED, GROSS EXCHANGE RESERVES WILL

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ACDA-05 FEA-01 INT-05 OES-02 /094 W

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R 040902Z NOV 74

FM AMEMBASSY SEOUL

TO SECSTATE WASHDC 6760

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HONG KONG FOR REGFINATT

CONTINUE BE MAINTAINED WITHIN ABOUT DOLS 50 MILLION OF END 1973 LEVEL, E.G., DOLS 980 MILLION ON SEPTEMBER 30, EQUAL TO ABOUT 1.5 TIMES CURRENT MONTHLY IMPORTS OF GOODS AND SERVICES. DUE TO HEAVY RELIANCE ON BANK LOANS AND CREDITS, HOWEVER, NET FOREIGN ASSETS WILL FALL AT LEAST DOLS 600 MILLION BELOW END 1973 LEVEL OF DOLS 945 MILLION. (NET FOREIGN ASSET DOLLAR FIGURE NOT PUBLISHED AND WILL BECOME INCREASINGLY SENSITIVE.)

5. TO COMPLETE 1974 FINANCING, KOREANS ARE HOPING TO OBTAIN (A) AN ADDITIONAL DOLS 75 MILLION FROM IMF OIL CREDIT FACILITY THROUGH SPECIAL BOARD DECISION SCHEDULED FOR NOVEMBER 11, AND (B) DOLS 200 MILLION LONG-TERM BANK LOAN BEING SYNDICATED BY FOUR LARGE AMERICAN BANKS, WITH DOLS 100 MILLION REPORTEDLY TO BE DRAWN IN 1974 AND REMAINDER IN 1975. KOREAN DEVELOPMENT BANK RECENTLY SOLD DOLS 19 MILLION IN GUARANTEED BONDS TO UNITED ARAB EMIRATES AND SEARCH FOR CONFIDENTIAL

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ARAB FUNDS CONTINUES, THOUGH IMMEDIATE PROSPECTS FOR LARGE-SCALE CASH LOANS CONSIDERED POOR.

6. 1975 BOP OUTLOOK: CURRENT OFFICIAL KOREAN POSITION IS THAT BOP DEFICIT WILL DECREASE SLIGHTLY IN 1975 DUE TO ASSUMED 20 PERCENT REAL INCREASE IN EXPORTS AND 14 PERCENT INCREASE IN IMPORTS. RELIANCE ON BANK LOANS AND CREDITS IS FORECAST TO DECREASE DUE TO INCREASE OF ABOUT DOLS 235 MILLION IN REGULAR LONG-TERM CAPITAL (INCLUDING OVER DOLS 100 MILLION IN PL 480 AND DOLS 75-100 MILLION IN IBRD PROGRAM LOAN) AND DOLS 120 MILLION IN IMF CREDITS FROM OIL FACILITY AND NEW EXTENDED FACILITY. GROSS EXCHANGE RESERVES ARE FORECAST TO INCREASE SOMEWHAT BUT NET FOREIGN ASSETS WOULD FALL FURTHER. A SIMILAR BOP IMPROVEMENT IS ALSO FORECAST FOR 1976 BASED ON 15 PERCENT REAL INCREASE IN EXPORTS. SINCE WORLD TRADE ASSUMED TO INCREASE ONLY 9 PERCENT IN REAL TERMS BETWEEN 1974 AND 1976, FORECAST EXPORTS REQUIRE INCREASE IN KOREA'S EXPORT SHARE FROM 9.67 PERCENT TO 9.85 PERCENT OF WORLD TOTAL.

7. VULNERABILITY OF THIS FORECAST TO A PROLONGED DECLINE IN KOREAN EXPORTS IS OBVIOUS. FOR EXAMPLE, 20 PERCENT FALL IN EXPORTS PLUS 10 PERCENT DECLINE IN IMPORTS IN 1975 WOULD WIDEN BOP DEFICIT BY ABOUT DOLS 300 MILLION TO AT LEAST 1.7 BILLION. NET NEED FOR BANK LOANS AND CREDITS WOULD THEN

INCREASE FROM ESTIMATED DOLS 540 MILLION IN 1974 TO OVER DOLS 700 MILLION IN 1975, OR MORE IF IMF CREDITS AND SOME ASSUMED CAPITAL INFLOWS DO NOT MATERIALIZE. NET FOREIGN ASSETS WOULD THEN ALMOST CERTAINLY FALL TO NEAR ZERO. SERIOUSNESS OF THIS PROBLEM IS HIGHLIGHTED BY DIFFICULTIES KOREANS HAVE HAD IN OBTAINING LARGE BANK LOANS IN RECENT MONTHS. U.S. BANKERS HAVE CITED SCARCITY FUNDS, ALREADY LARGE EXPOSURE TO KOREA (E.G., THROUGH TRADE REFINANCE AND NUMEROUS EX-IM LOANS IN PROCESS) AND PERCEIVED INCREASE IN POLITICAL RISK. FOUR AMERICAN BANKS ATTEMPTING TO RAISE DOLS 200 MILLION PROCEEDED AFTER ASSURANCE BY FINANCE MINISTER KIM THAT NO FURTHER SUCH FUNDS WILL BE REQUIRED IN 1974-75, BASED ON OPTIMISTIC BOP FORECAST CITED ABOVE. NUMEROUS BANKERS HAVE VISITED HERE RECENTLY, REFLECTING HOME OFFICE CONCERN RE ADVISABILITY CURRENT OR GREATER EXPOSURE TO KOREA. HOWEVER, THEIR MAIN CONCERNS HAVE BEEN POLITICAL RATHER THAN CONFIDENTIAL

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ECONOMIC. SINCE BANKERS PLACE EMPHASIS ON GROSS RESERVE LEVEL, ROKG HAS PAID HIGH INTEREST COSTS NECESSARY TO KEEP LEVEL UP.

8. THUS PROSPECTIVE DECLINE IN EXPORTS MAY POSE SERIOUS FINANCING PROBLEMS FOR KOREA, DESPITE DEBT-SERVICING RATIO OF ONLY 12 PERCENT AND GOOD LONG-TERM GROWTH PROSPECTS. WE DOUBT THAT KOREAN DEVALUATION IN PRESENT SITUATION WOULD HELP OBTAIN NEW FUNDS OR EXPAND EXPORTS SINCE IT WOULD ALMOST CERTAINLY LEAD TO COMPETITIVE DEVALUATIONS BY TAIWAN AND HONG KONG, WHOSE EXPORTS HAVE BEEN GROWING LESS RAPIDLY. CURRENT PROBLEM IS EXTERNAL DEMAND, NOT KOREAN PRICES, AND AGGRESSIVE KOREAN MARKETING, E.G., IN TEXTILES, COULD LEAD TO NEW BARRIERS IN JAPAN AND U.S. ASIDE FROM RELATIVELY SMALL OFFICIAL OR BANK LOANS POSSIBLE FROM JAPAN AND PERHAPS GERMANY, OTHER SOURCES OF LARGE-SCALE CASH LOANS WOULD BE (A) DIRECT LOANS FROM MIDDLE EAST OIL PRODUCERS, WHO HAVE NOT BEEN ENCOURAGING SO FAR, OR (B) ACCESS TO POSSIBLE SPECIAL NEW FUNDS FOR COUNTRIES MOST SERIOUSLY AFFECTED (MSA) BY OIL CRISIS. U.S. AND INTERNATIONAL ORGANIZATIONS HAVE SO FAR CLASSIFIED KOREA AS COUNTRY ABLE TO BORROW SUFFICIENT FUNDS ON CAPITAL MARKETS (I.E., NOT AN MSA) BUT THIS CLASSIFICATION MAY HAVE TO BE REVISED IN 1975.

9. IMPLICATIONS FOR U.S.: LIKE MANY COUNTRIES, KOREA IS BEING PUSHED INTO DANGEROUS FOREIGN EXCHANGE SITUATION BY COMBINATION HIGHER IMPORT PRICES AND LOWER DEMAND FOR EXPORTS. U.S. INTERESTS IN KOREA WOULD SEEM TO WARRANT FOLLOWING ACTIONS: (A) RESUMPTION OF DELIVERIES UNDER PREVIOUS PL 480 COMMITMENTS, AT HIGHEST LEVEL POSSIBLE; (B) CONTINUATION OF LARGE-SCALE EXIM BANK LENDING AS WARRANTED BY PROJECT REVIEW; (C) SUPPORT OF KOREAN REQUEST FOR UP TO \$100

MILLION IN PROGRAM LOAN FROM IBRD; (D) CONTINUED ASSISTANCE TO ROKG IN SEEKING ITS "FAIR SHARE" OF SPECIAL INTERNATIONAL FUNDS BEING MADE AVAILABLE, E.G., THROUGH IMF OIL CREDIT FACILITY, INCLUDING POSSIBLE FUTURE RECLASSIFICATION AS AN MSA DEFICIT COUNTRY; AND (E) ENCOURAGEMENT OF OIL PRODUCERS TO INCLUDE KOREA IN THEIR CONSIDERATION OF LOANS TO COUNTRIES HARD HIT BY EFFECTS OF OIL PRICE INCREASE.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: GOVERNMENT BUDGET, ECONOMIC CONDITIONS, INDUSTRIAL PRODUCTION, EXPORTS
Control Number: n/a
Copy: SINGLE
Draft Date: 04 NOV 1974
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: SmithRJ
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974SEOUL07321
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D740316-0389
From: SEOUL
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t19741173/aaaacjxp.tel
Line Count: 284
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators:
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: A. SEOUL A-257
Review Action: RELEASED, APPROVED
Review Authority: SmithRJ
Review Comment: n/a
Review Content Flags:
Review Date: 31 JUL 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <31 JUL 2002 by kelleyw0>; APPROVED <25 MAR 2003 by SmithRJ>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: ECONOMIC RECESSION WILL BRING FOREIGN FINANCING AND UNEMPLOYMENT PROBLEMS
TAGS: ECON, PINT, KS
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005